Economic Commentary

Fourth Quarter 2024

Inflationary Pressure Subsides, Core Still Elevated

Significant progress was made on the inflation front during 2024. Despite periods of uneven movement during the year, the latest Canadian CPI reading came in at 1.9%, below the 2.0% target of the Bank of Canada. Inflation in the U.S. still has more work to do in order to get to the target level as it currently sits at 2.7%. Inflation levels in the Eurozone and the United Kingdom have improved as well, with the latest readings at 2.2% and 2.6%, respectively. These levels have declined significantly from the peak levels that were reached in 2022, which ranged from 8.1% to 11.1%. Core inflation, which is a key indicator for global central banks, has remained elevated, however, with further improvement required in order to give central bankers more comfort that inflation has been tamed. Inflation has been the main focus of global financial markets over the past several years and was the prime factor contributing to the swift and dramatic increase in interest rates that occurred following the COVID pandemic. The improvement made on the inflation front has allowed central banks to focus on other factors impacting monetary policy, particularly the state of labour markets, which have exhibited some weakness over the past year.

Central Banks Pace of Cuts Could Slow in 2025

Both the Bank of Canada and the U.S. Federal Reserve cut interest rates during the fourth quarter. The Bank of Canada lowered rates by 50 bp at each of its two meetings, with the overnight rate now sitting at 3.25%. This level represents the upper band of the central bank's neutral range, which is between 2.25% and 3.25%. The Bank of Canada cited softness in the labour market as well as a weaker economic growth outlook as reasons behind the large rate cuts. The Bank of Canada lowered rates five times during the year for a total decline of 175 bp. These cuts represented the most aggressive moves made by any of the G7 countries during 2024.

The U.S. Federal Reserve, which started cutting rates in September by 50 bp, added two more rate cuts of 25 bp each at its two meetings during the quarter. This brought the total rate cuts for the year to 100 bp. The Fed did state, however, that the pace of interest rate cuts could slow in 2025 as inflation remains sticky, with headline inflation at 2.7% and the core reading at 3.3%. The Fed indicated that they are now forecasting only two interest rate cuts occurring in 2025. This is lower than what was previously anticipated. This divergence in monetary policy between Canada and the U.S., with the Bank of Canada lowering rates 75 bp more than the Fed in 2024, has had a dramatic negative impact on the Canadian dollar. The Canadian/U.S. dollar exchange rate weakened from 1.35 to 1.44 during the quarter. In other markets, the European Central Bank lowered rates by 50 bp during the quarter while the Bank of England cut rates by 25 bp.

Increase in Labour Force Drives Unemployment Rate Higher

Despite adding 51,000 new jobs in November, the Canadian unemployment rate increased to 6.8% from 6.5%, the highest level in eight years, excluding the period during the COVID pandemic. The major reason behind the surprising increase

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Key Metrics

Indicator	Value	Chg Q4	Chg 1Y
S&P/TSX Composite	24,727.94	3.8%	21.7%
S&P 500 (USD)	5,881.63	2.4%	25.0%
iShares MSCI EAFE ETF (USD)	75.61	-8.4%	3.5%
USD/CAD	$ 0.70	-6.0%	-7.9%
WTI Crude ($/bl))	$ 71.72	5.2%	0.1%
GoC 10Y Bond	3.23%	27 bps	12 bps
GoC Deposit Rate	3.25%	-100 bps	-175 bps
Cdn CPI YoY	1.9%	0.3%	-1.5%
US 10Y Treasury	4.57%	79 bps	69 bps
Fed Funds Rate	4.50%	-50 bps	-100 bps
USD CPI YoY	2.7%	0.3%	-0.7%

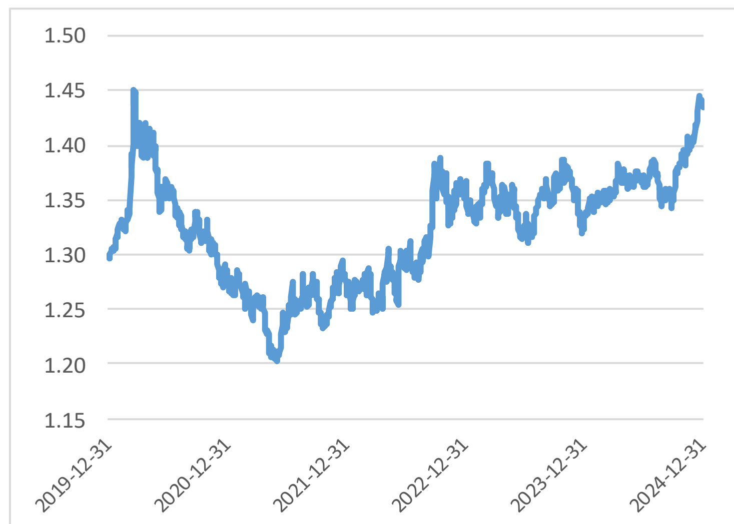
Top Themes

Core Inflation proving more stubborn than headline levels

Central banks continue to lower rates, but pace could slow into new year

Trump election victory leads to threat of increased tariffs

Top Chart: Canadian/U.S. Dollar Exchange Rate



Source: Bloomberg, Lincluden

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in the unemployment rate was the significant increase in the size of the Canadian labour force. There was an increase of 138,000 people entering the labour force in November, many of which were not able to find a job.

Economic growth is still increasing at a somewhat healthy pace, particularly in the U.S., where third quarter GDP came in at 3.1%. Canadian GDP has not been as strong but it is still exhibiting modest growth on a monthly basis. The Trump victory in the U.S. election will no doubt have an impact on global markets in 2025. Trump has threatened stiff tariffs on goods entering the U.S. from Canada, Mexico and China. If these measures are implemented, it could negatively impact global growth as well as add to inflationary pressures.

Equity Markets Strengthen Further While Bond Yields Move Higher

The Canadian equity market continued to strengthen further during the fourth quarter, capping off a surprisingly strong year with an annual return close to 18%. U.S. equity markets performed even better on the back of stellar returns in the technology sector. Further declines in interest rates by both the Bank of Canada and the U.S. Federal Reserve contributed to the on-going strength in the equity markets. Bond yields moved higher during the quarter, particularly in the U.S. market, as expectations for future rate cuts by the Fed have been pared back for 2025. The yield on the benchmark 10 year U.S. Treasury bond increased by 79 bp, finishing the quarter at 4.57%. The yield on the benchmark bond began the year at 3.88%.